Trading Patterns For Stocks And Commodities

It doesn't matter if you are a long-term investor, short swing trader or day trader, you are always looking for an advantageous spot to enter your position.

As someone who has been studying the markets since 1962, I assure you that not all market moves are predictable. But there are some reliable patterns I have discovered over the years that can be of great value. Shortly I will introduce you to one pattern I use consistently.

Markets seldom bottom on what is commonly known as the key reversal... I've lectured on that point for many years. Markets have more twists and turns to them than a climb up the Cooke City Highway in my native home of Montana.

Just like that highway, each twist and turn is a little different than the last one. Yet, there are similarities in roads as well as markets. I would like to show you a very simple pattern with a solid record of calling short term explosive moves in stocks and commodities.

Introducing… The False Break

Buy And Sell Pattern

The idea of the pattern is pretty simple... and pretty emotional. What I am looking for - to set up a buy signal - is a day that closes below the prior day's low. Such days, (aka, naked close days), look very bearish on a chart and typically act as a continuation of a market decline. Usually when this condition is reversed (i.e. the very next day it takes out the high of the down

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close day), we often find good market follow through to the upside.

The exact opposite of this creates a sell signal; a market makes a close greater than the prior day's high, then the very next day takes out the low of the up close day. I have taught this to many traders at seminars and written about it in my books for several years.

However, there is a new dimension we can add to this pattern. I am surprised people have not noticed this little twist that I am about to show you. It is simply this; ***if on the day following the naked close we have a naked close in the opposite direction, we typically have established a reversal point in the market.***

In other words, we have a down close below the prior day's low. Then the very next day we have an up close and a close above the high of the down close day. That is extremely unusual action and tends to be quite bullish.

The opposite of course will be a bearish situation, a day that closes greater than the prior day's high and then the very next day closes below that same day's low.

The following chart gives you an idea of how these patterns actually operate in the marketplace.

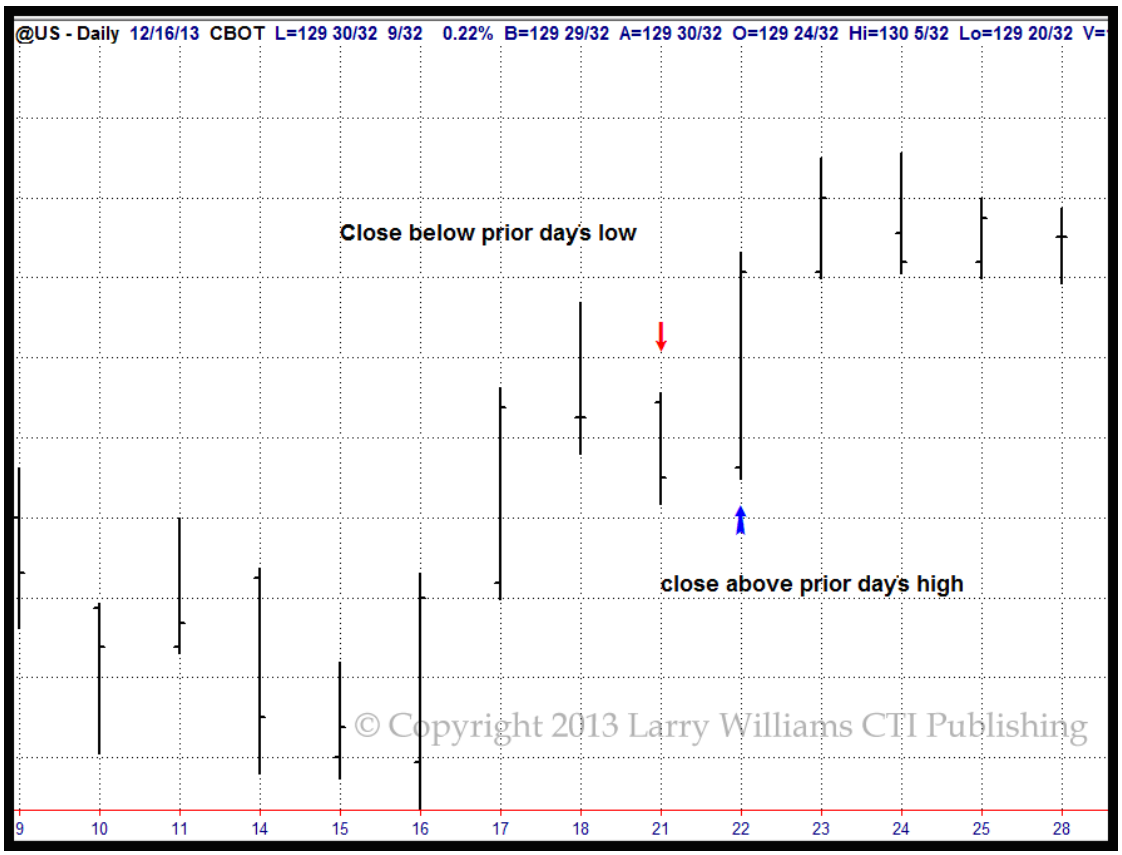

Figure 1: Treasure Bonds Example of Back to Back Naked Close Days

The signals here are shown on Bonds, though it does not matter what market you apply this pattern to. It seems to be a pattern that is universally applicable for traders. The charts of GOOG, GM and XOM show the same pattern works in the stock market as well.

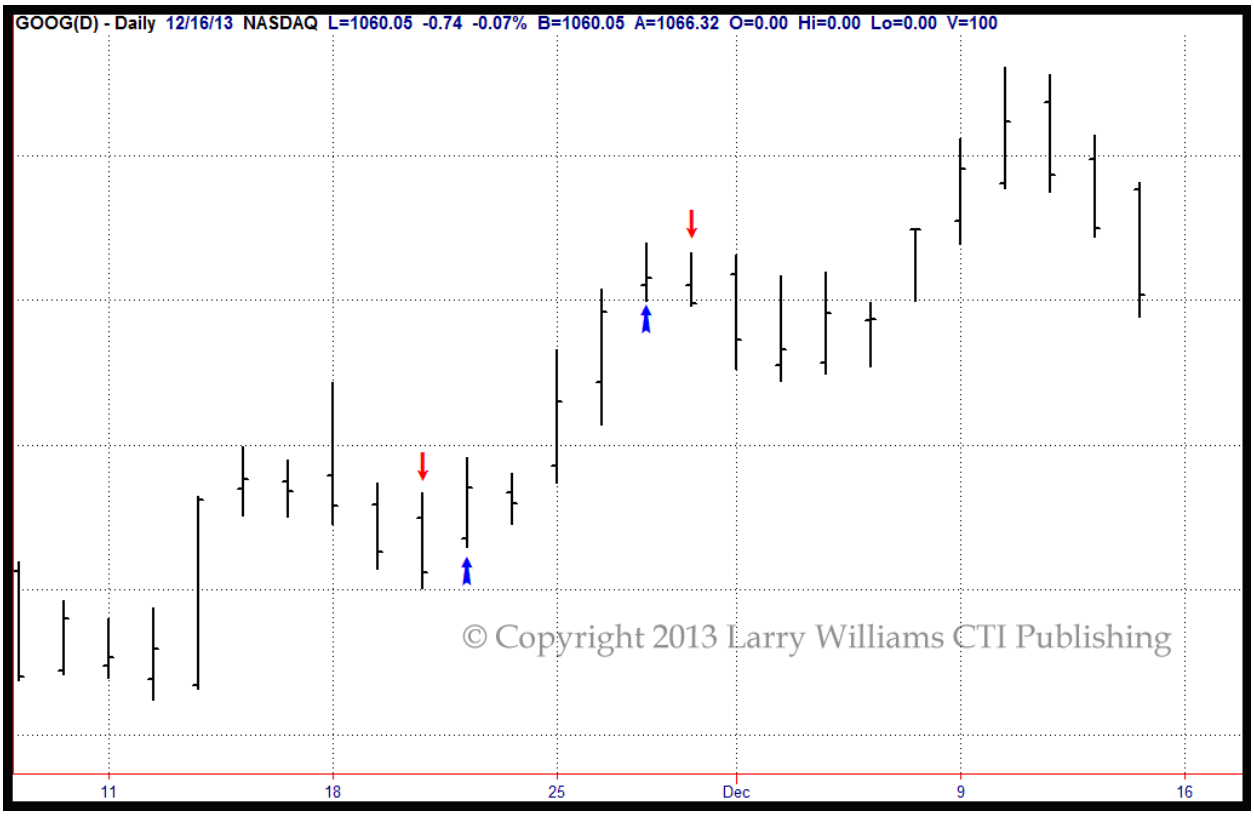

Figure 2: Google Daily Bars - False Break Pattern

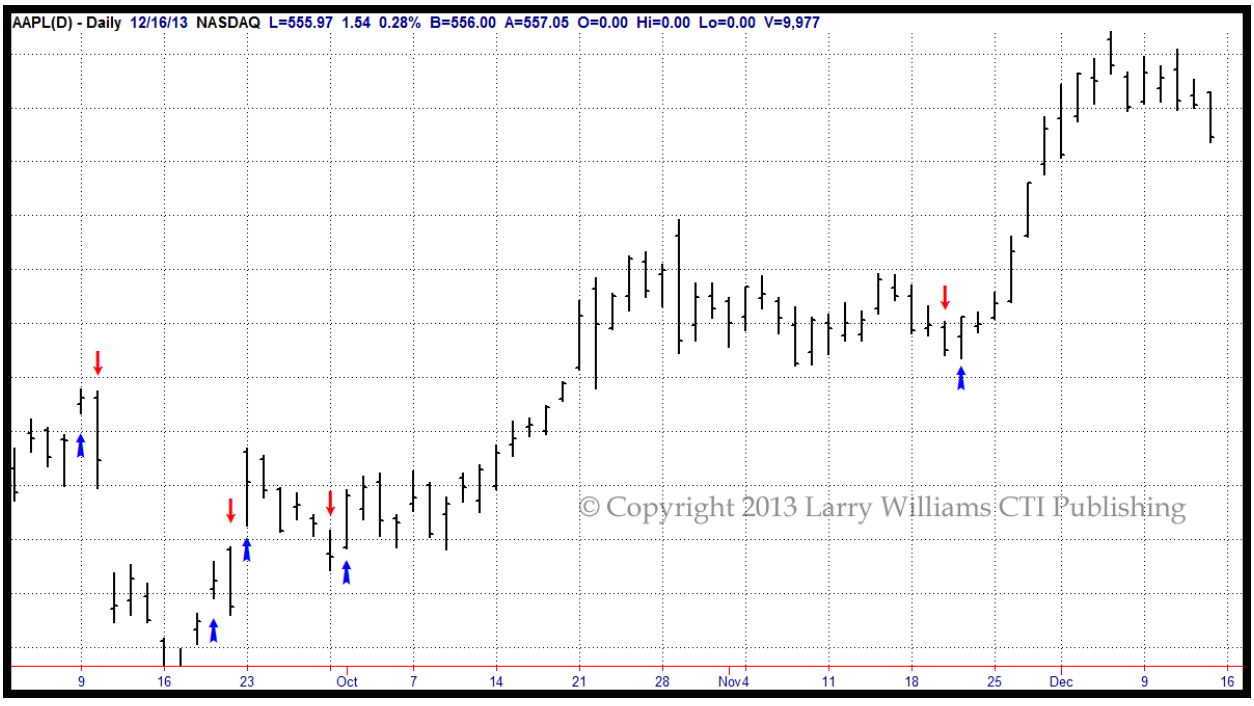

Figure 3: Apple Daily Bars - False Break Pattern

Figure 4 Exxon Daily Bars - False Break Pattern

Of course that is not to say it is without problems. Certainly not all trades will be as good as the ones you see here. In fact, let's take a look at a current chart of Wheat to see more examples.

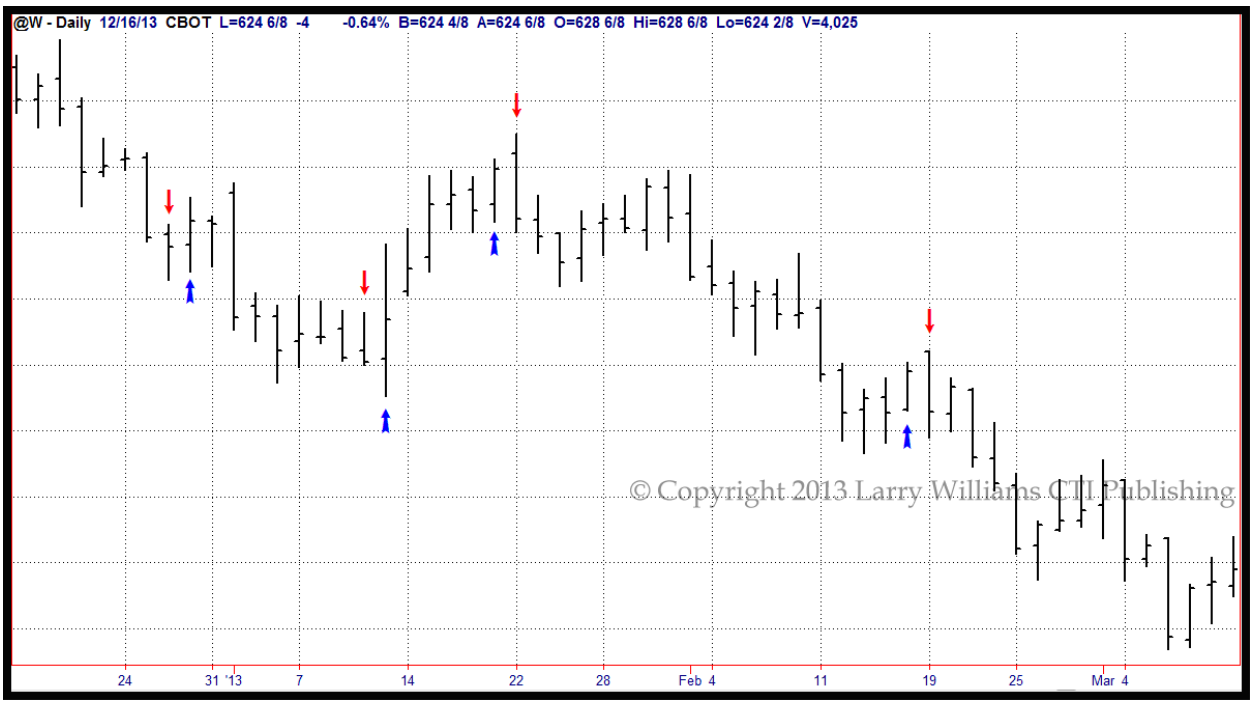

Figure 5 Wheat Daily Bars - False Break Pattern

In Figure 5 we see four examples of these fake break signals. The first pattern for a buy was certainly not where we would have wanted to go long. The following three patterns were good entries.

However, there is an important difference between these signals. The difference is that in the first signal in Figure 5 that while we had a down naked close then an up naked close. There was no follow through the day after the up close.

In the next two patterns <u>following the second day's action, the market did continue following through in the direction of the immediate reversal day.</u>

It appears it is best to wait for confirmation… something like this:

1) **Market closes below prior low**
2) **Market then closes above the high of the low close day**
3) **Market then follows through the second close day.**

I have clarified this on the following chart of Silver, in Figure 6.

@SI(D) - Daily 12/16/13 COMEX L=19.490 -0.114 -0.58% B=19.490 A=19.495 O=19.655 Hi=19.675 Lo=19.445 V=6,592
no follow through
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Jul 11 18 25 Aug 8 15 22 29 Sep 6 12 19 26 Oct 10 17 24 Nov 7 14

Figure 6 Silver Daily Bars - False Break Pattern Confirmation

I hope this will help you further understand this technique. Again, I've highlighted the days when the False Break Pattern occurred but also have noted the days when there was no follow through the next day.

As you see, the first, second and third signals did have follow through while there was no follow through on the buy signal in the middle of September, nor the sell pattern the very next day, but there was follow through as prices broke out of the trading range to the downside.

There are a good number of ways to use this technique. It can be used to help you spot points to get back into a market in phase with a longer-term trend. With that in mind, let's take a look at potential signals from the pattern in an up trending market.

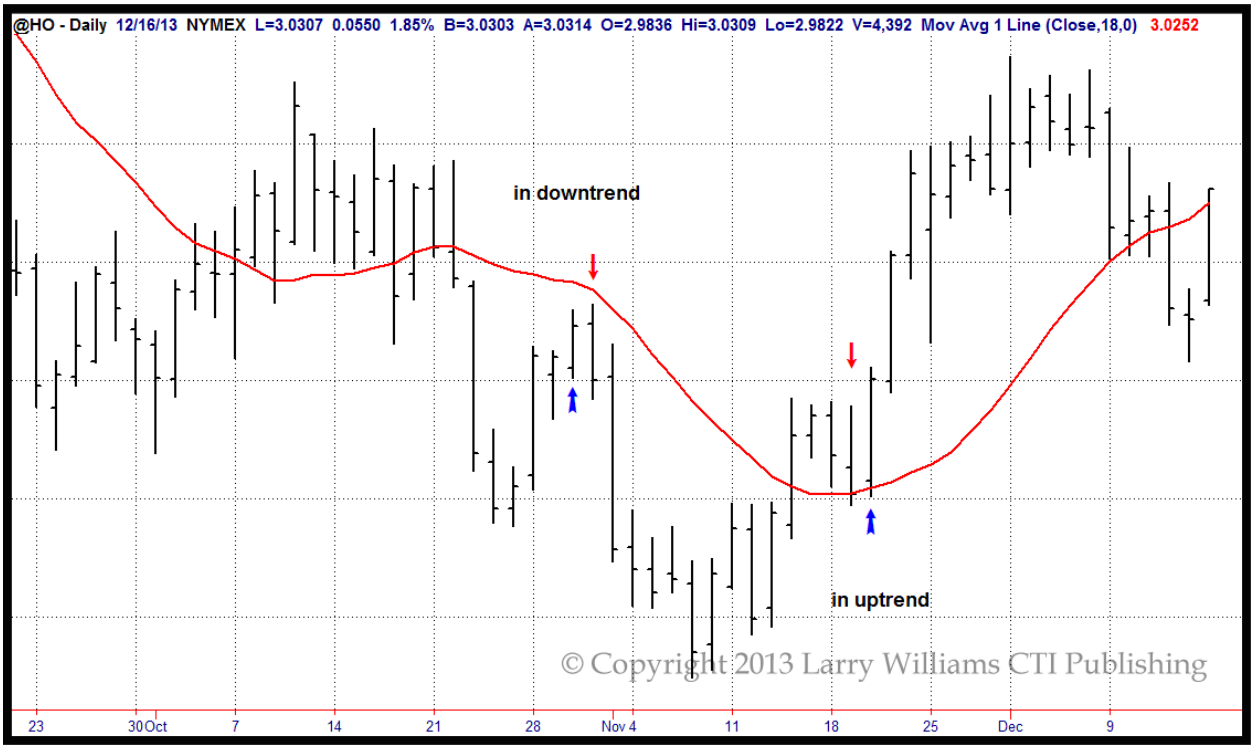

Figure 7 Heating Oil Daily Bars - False Break Pattern Confirmation

If we use the venerable 18 day moving average as our measure of trend and require it to be in an uptrend or the signal taking place above the 18 bar average, we get some pretty good short-term moves in the marketplace.

Granted nothing is perfect… not even this pattern… but as you can see it occurs frequently and frequently with explosive moves. There are numerous things you can do to filter out some of the trades such as trend, using accumulation distribution, seasonal patterns and the Commitment of Trader report.

Let me be the first to say, not all trades will be that successful. You do have a problem in that sometimes price will take out the prior day's high but not close above the high. In that case you will want to put in a closer trailing stop. In the case of the our pattern, your stop can trail at the prior bar's low or simply have your stop at the low of the down close bar if you are buying or at the high of the up close bar if you're selling.

In any event, I think you'll find this is a nice addition to your trading patterns... it is easy to follow. I suggest you use this trading pattern in combination with other indicators such as my Williams %R, Stochastics, MACD, or Bollinger Bands. I think you'll be happy that you added it to your repertoire of trading patterns.

Like It?

Have you learned from this special report? I hope so.

I share ideas like this as well as actual trade setups ever weekend on my video market commentary, "Larry TV". I show you my charts, explaining trading opportunities for the upcoming week.

One thing traders love on "Larry TV" is at the first of the month I give the specific days when the E-Minis, Gold and Bonds are most likely to rally or decline during the coming month.

You can go here to read more and watch past Larry TV videos:
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Good Luck & Good Trading,

Larry Williams

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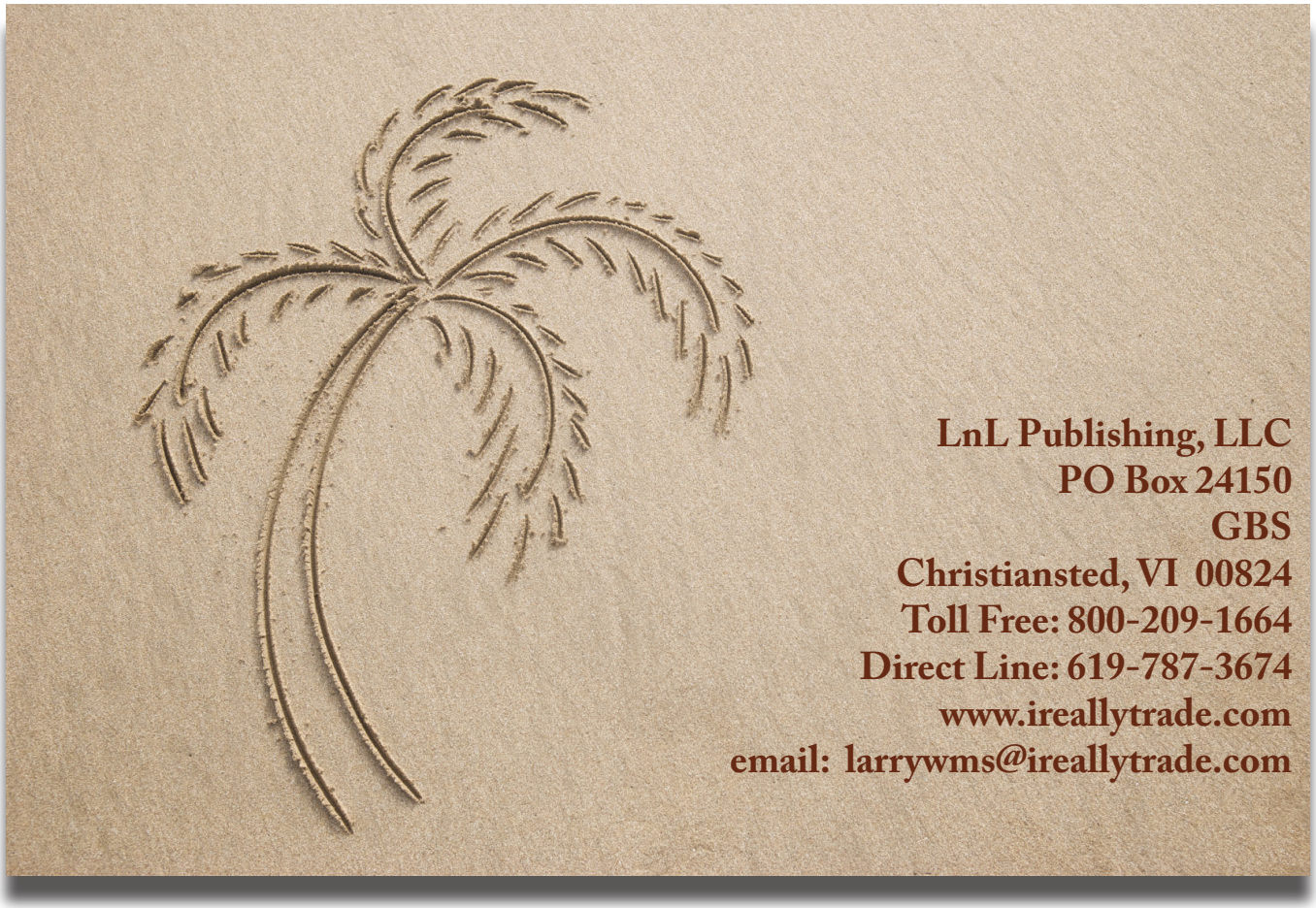

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